IRS Oversight Board

Electronic Filing 2009
Annual Report to Congress

January 2010

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Executive Summary

The electronic filing of tax returns (e-file) is part of a broader range of tax-related technology applications embedded in the concept of electronic tax administration (ETA). Both the National Commission on Restructuring the IRS and IRS Restructuring and Reform Act of 1998 (RRA 98) embraced an ETA vision in which the vast majority of taxpayer interactions with the tax administration system would be handled electronically. Such a vision is also in keeping with the E-Government Act of 2002 and is embedded in key IRS long-term planning endeavors including the newly updated *IRS Strategic Plan 2009-2013*. Electronic tax administration is the foundation for a modernized IRS that provides secure, convenient, timely and accurate services to taxpayers, and to the tax professionals and IRS employees who serve them.

Having secure and easy-to-use systems for the electronic filing of major tax returns is a critical component of the ETA vision. As a result, RRA 98 established a goal that 80 percent of returns be filed electronically by the year 2007. It also required that the IRS Oversight Board submit an annual report to Congress addressing the progress the IRS is making in meeting that goal, and placed a similar reporting responsibility on the Electronic Tax Administration Advisory Committee (ETAAC).

The IRS did not meet the challenging goal of an 80 percent e-file rate by 2007 called for in RRA 98. Nevertheless, the Board believes that as a direct result of that explicit goal, the IRS has made solid progress toward the ETA vision articulated in that landmark legislation. In 2009, nearly 67 percent of all individual income tax returns were filed electronically (up from 20 percent in 1998), and roughly 56 percent of all major individual, business and tax exempt returns combined. Further, these e-file participation rates for 2009 are just the latest data points on what are firm upward trends in the shares of tax returns filed electronically. Federal tax returns filed on paper are steadily becoming a thing of the past.

In addition, the IRS has in place today Modernized e-File (MeF) platforms for most of the major business and exempt organization returns, along with the expected delivery of the first phase of its Form 1040 MeF application starting with the 2010 filing season. These MeF platforms are web-based systems that allow electronic filing through the Internet and greatly facilitate e-file by using highly flexible, industry standard technology for identifying, storing and transmitting data. The development and deployment of MeF applications are a major part of the IRS' Business Systems Modernization (BSM) effort and reflect the technological foundation for electronic filing in the modern age. The IRS has also deployed many electronic products and services on its website (*www.IRS.gov*). A number of these applications are of great assistance to taxpayers and tax professionals, and help reduce the burden taxpayers face in complying with tax laws. All these developments reflect solid progress toward the ETA vision.

Of course, progress on e-file and the ETA vision is not solely attributable to the IRS. Indeed, this progress could not have been achieved without the active support and cooperation of the professional tax community, which includes return preparers, tax software developers, and the many other tax-related service providers in the private sector. Further, the continued support and interest of policymakers has been tremendously important to the advancement of e-file and the ETA vision. This report highlights a number of key actions taken by policymakers and IRS partners in the tax community to increase e-file and further ETA. Examples include the passage of a new law that will mandate certain return preparers of individual returns to e-file, and embedding free electronic filing of federal returns within certain retail tax preparation software.

The report also offers the Board's comments on some of the thoughtful recommendations recently put forth by the ETAAC to increase e-file partcipation even further and help achieve the broader ETA objectives.

With the Board's approval, the IRS has recommitted itself to the 80 percent e-file goal first promulgated in RRA 98. That reframed goal calls for an overall 80 percent e-file participation rate for all major individual, business and exempt organization tax returns by the year of 2012. However, reaching that 80 percent e-file rate will not be easy. The Board's analysis indicates that under the current rate of growth, even with the added boost from the electronic filing mandate for individual return preparers, the e-file rate for all major tax returns will still fall short of the 80 percent goal by 2012. The IRS must also overcome other major challenges to achieving the full ETA vision. These include acquiring the funding, and marshalling the necessary management and employee skills, to deliver the key components of the IRS' business systems modernization efforts and replace the aging computer technology that prevents the agency from moving fully into the modern age.

Nevertheless, the Board believes the IRS can meet these challenges and achieve the 80 percent e-file goal by 2012 through further innovation, the continued support from policymakers, and the advice and assistance of IRS' key partners in the tax community. The Board further highlights in this report the importance of the IRS focusing on three particular taxpayer segments that are key to attaining the 80 percent goal because these segments comprise the bulk of the tax returns filed on paper: individual returns submitted through paid preparers; individual returns filed by self-preparers; and Form 941 tax returns filed by employers in the business and non-profit sectors.

The Board also encourages the IRS to remain focused on the broader ETA vision and not just the e-file goal of 80 percent. For example, while it recommends that the IRS revisit the patchwork of electronic filing mandates in the business and employment return areas to make them more effective, the Board also encourages the IRS to reconsider such requirements from a more strategic point of view. That view would not only consider requirements that would help attain the 80 percent goal, it would also consider how the data being captured electronically could be put to use in new and innovative ways to improve service to taxpayers and increase voluntary compliance.

Introduction

Purpose and Scope

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98) set a challenging goal that called for 80 percent of returns to be filed electronically by the year 2007. RRA 98 also required the IRS Oversight Board to submit an annual report to Congress addressing the IRS' progress to meet that goal. The Act placed a similar reporting responsibility on the Electronic Tax Administration Advisory Committee (ETAAC), whose members are chosen for their particular expertise in the electronic exchange of tax administration information.

At the time RRA 98 was enacted, only 20 percent of individual income tax returns were filed electronically. By filing year 2007, that percentage grew to nearly 58 percent. The IRS did not achieve the 80 percent electronic filing (e-file) goal. However, as expressed in its previous e-file reports to Congress, the Board believes that the IRS and its private sector partners in the professional tax community have made significant progress in advancing electronic tax administration.

This progress includes substantially increasing e-file participation from a small minority of filers to a clear majority. It also includes building key parts of the technological foundations for a more modern electronic tax administration environment, such as the various web-based Modernized e-File (MeF) applications that allow the electronic filing of corporate, partnership, exempt organization and excise tax returns through the Internet. The Board further believes that the progress achieved is a direct result of the 80 percent goal articulated by RRA 98 and the continued attention policymakers devote to assessing how well the IRS was advancing toward that target.

In early 2007, the Board approved a new, IRS-proposed long-term goal that recommits the agency to the 80 percent e-file target. The new goal calls for a combined e-file rate of 80 percent for all major tax returns filed by individuals, businesses, and tax exempt organizations by the year 2012.

This report to Congress provides the Board's latest assessment of the IRS' progress toward the 2012 e-file goal of 80 percent for all major tax returns, along with an update on other important electronic tax administration matters. As it has in the past, the Board also uses this report to provide additional perspective and strategic comment on key recommendations put forth by the experts on the ETAAC in their 2009 report to Congress.[1]

The Strategic Importance of Electronic Tax Administration and e-File

The electronic filing of tax returns is only part of a broader range of tax-related technology applications embedded in the concept of electronic tax administration. Electronic tax administration (ETA) is the foundation for a modernized IRS that provides secure, convenient, timely and accurate services to taxpayers, and to the tax professionals and IRS employees who serve them. The full vision for a modern ETA environment goes beyond just e-filing and seeks to make electronic interactions among taxpayers, tax practitioners, and the IRS the norm. These electronic interactions include the entire range of pre-filing, filing and post-filing tax activities that taxpayers and their representatives may engage in with the IRS, including the ability to resolve taxpayer account issues over the Internet.

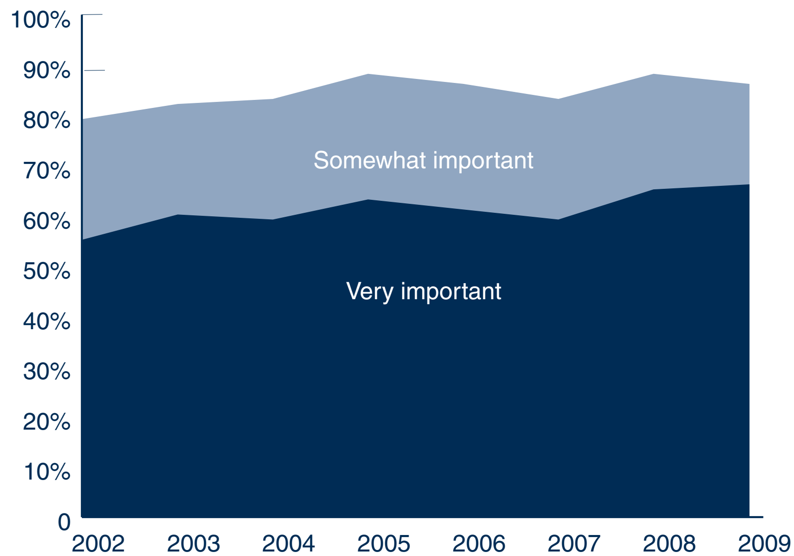
Both the National Commission on Restructuring the IRS and RRA 98 embraced an ETA vision in which the vast majority of tax interactions would be handled electronically. Such a vision is also in keeping with the E-Government Act of 2002, which seeks to promote the use of the Internet and other information technologies to improve government services for citizens and internal government operations.[2] The ETA vision is further embedded in key IRS long-term planning initiatives, including the *Taxpayer Assistance Blueprint*, the *IRS Information Technology (IT) Modernization Vision and Strategy*, and the newly updated *IRS Strategic Plan 2009-2013*.

Indeed, a key objective articulated by the IRS in its updated strategic plan is “to build and deploy advanced information technology systems, processes, and tools to improve IRS efficiency and productivity.” Associated strategies in the IRS strategic plan to achieve that objective include: (a) deliver modernized systems designed to store and manage taxpayer data, strengthen enforcement efforts, and meet service expectations of taxpayers and tax practitioners; and (b) expand online tools and services.[3] Thus, ETA is a central part of the IRS’ strategic thinking and remains the means by which IRS can evolve into a truly modern organization that can deliver world-class quality service. Achievement of the ETA vision, in turn, is only possible if a highly successfully e-file environment exists. Thus, the focus provided by the 80 percent e-file goal by 2012 remains a valuable reference point by which to gauge IRS success. It can also help inform the decisions of tax administrators, tax professionals, and policymakers, whose concerted actions are the key to whether the goal is achieved.

Taxpayer Views on e-File and Electronic Tax Administration

Americans know that electronic filing is important to tax administration. As shown in Figure 1, the Board’s annual taxpayer attitude survey regularly reveals that well over 80 percent of the general public believes it is “very important” or “somewhat important” that the IRS provides opportunities for electronic filing. Further, the share of the public saying it is very important has generally grown over the years, going from 55 percent in 2002, to 66 percent in 2009.

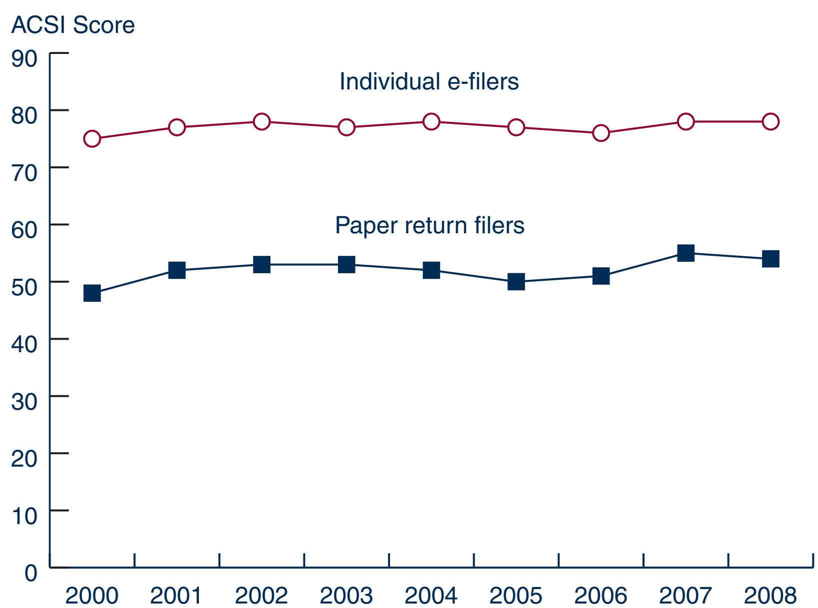
Figure 1. Percent of Public Who Say It Is Important That the IRS Provides Opportunites for Electronic Filing



Source: IRS Oversight Board Taxpayer Attitude Survey

In addition, as shown in Figure 2, individuals who file their returns electronically consistently report a much higher satisfaction level with the filing process, than do the individuals who file their returns on paper. In 2008, the latest year for which data are available, the American Customer Satisfaction Index (ACSI) score for individual e-filers was 78 compared to 54 for paper filers.

Figure 2. American Customer Satisfaction Index Scores 2000 - 2008

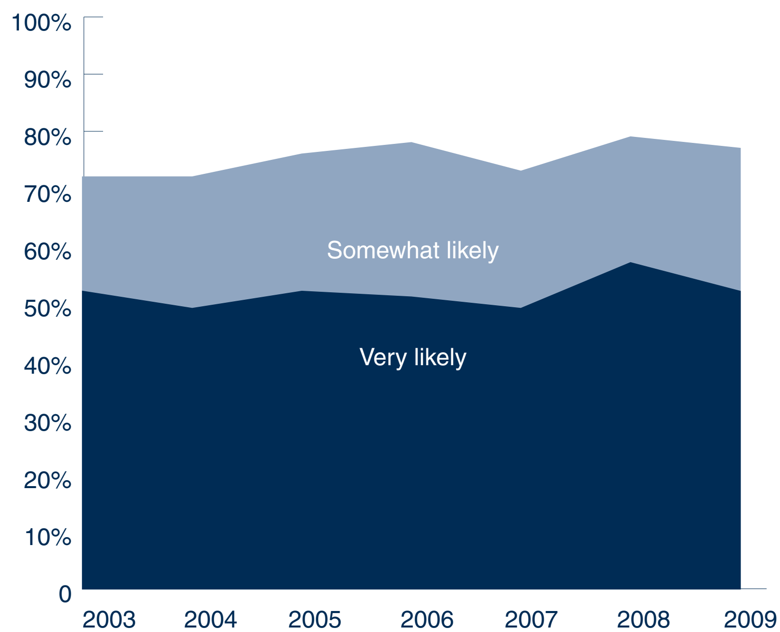


Source: www.theacsi.org

Satisfaction with electronic filing is also not limited to individual return filers. It extends to business return filers as well. For example, a survey of filers of corporation income tax returns (i.e., Forms 1120 and 1120S) in May 2009 revealed that 92 percent of them said that they were very satisfied with their Form 1120 e-filing experience (with another six percent somewhat satisfied). In addition, this level of satisfaction was the same for both those business taxpayers mandated to e-file their corporation tax returns and those who e-filed their corporate returns voluntarily.[4]

It is also interesting to note that even though a majority of individual taxpayers use a paid return preparer to complete their income tax return, nearly 80 percent of the general public regularly say they would be very likely or somewhat likely to use the IRS website (see Figure 3).

Figure 3. Percent of Public Who Say They Would Be Likely to Use the IRS Website



Source: IRS Oversight Board Taxpayer Attitude Survey

Notable Developments in Electronic Tax Administration During 2009

The IRS and its partners in the professional tax community have developed and introduced many new and useful electronic tax products and services over the years. The Board has noted a number of these major ETA advancements in its prior reports to Congress.[5] However, designing and delivering new technology that serves taxpayers better also entails an iterative process. It is a process in which the IRS, with input from its stakeholders, regularly evaluates the utility of the new systems deployed, and those planned for the future, and makes modifications when necessary in the interest of improving overall service to taxpayers.

Highlighted below are some of the major developments during 2009 that have impacted the electronic tax interactions of individuals and businesses. Among these developments is a modification to the IRS' approach to modernizing its central taxpayer account record keeping system for individuals.

No-Cost Form 1040 e-File Embedded into Retail Tax Preparation Software

Perhaps the most significant advancement for e-file in 2009 was the decision by two major producers of retail tax preparation software for individual returns not to charge a fee to electronically file a Form 1040 return.[6] As will be shown in more detail later in this report, this action resulted in a significant increase in the number and percentage of individual tax returns filed online. This e-file advancement is especially important because it provides a new service to taxpayers who self-prepare their returns—a segment of the return filing population that is particularly critical to reaching the 80 percent e-file goal. As it did in its report last year, the Board applauds H&R Block and Intuit, Inc. for their decision to provide free federal e-filing.

Free Fillable Tax Forms Online

As part of the Free File program for 2009, individual taxpayers were able to fill out and file their tax returns online, for free, via a link provided on IRS.gov to the website of a particular company participating in the Free File Alliance. This new online application made about 100 IRS forms and schedules associated with individual income tax returns available in a "fillable" form. The application allowed taxpayers to enter their tax data, perform basic math calculations, sign electronically, print their returns for record keeping, and e-file their returns. While this fillable option did not include an "interview" process (i.e., a software driven question-and-answer format that probes the user about their tax-related financial circumstances) like the other Free File offerings, it was available for free to all taxpayers wishing to use it and regardless of their income level. The IRS reports that around 273,000 taxpayers used this new fillable form option to e-file.

Policymakers Enact an e-File Mandate for Individual Return Preparers

Similar to a proposal made in the President's fiscal year 2010 budget request for the IRS, Congress enacted legislation in late 2009 that requires certain federal tax return preparers to e-file. Embedded in the Worker, Homeownership, and Business Assistance Act of 2009, the new law establishes an e-file mandate for those preparers who file more than ten income tax returns for individuals, estates, or trusts. The law is effective for returns filed in calendar year 2011 (i.e., tax year 2010).[7] The Board has supported such an e-file mandate for several years, and it has long been a recommendation of several major stakeholders, including the ETAAC, the Treasury Inspector General for Tax Administration (TIGTA), and the Government Accountability Office (GAO). In addition, at least 20 states have already implemented some type of e-file mandates for preparers of their state individual income tax returns to achieve return processing cost savings and reduce the volume of tax returns submitted with errors.[8] The IRS has also revealed that the report on the second phase of its *Advancing E-File Study*, while still under review, will show that such a mandate on preparers would have a significant impact on the e-file rate.[9]

A later section of this report takes a closer look at the remaining volume of paper returns submitted by return preparers and the approximate impact of this new e-file mandate.

Form 8849 MeF for Business Return Filers

The IRS continued to expand its portfolio of MeF applications during 2009 with the addition of Form 8849, Claim For Refund of Excise Tax Returns and certain key schedules associated with it. The MeF platforms are web-based systems that allow electronic filing through the Internet and greatly facilitate e-file by using highly flexible, industry standard technology for identifying, storing, and transmitting data. The development and deployment of MeF applications are a major part of the IRS' Business Systems Modernization (BSM) effort and reflect the technological foundation for electronic filing in the modern age.

Andover Campus Ceases Processing of Paper Individual Returns

In June of 2009, the Andover (Massachusetts) Campus ceased its processing of individual returns filed on paper. The continued growth in e-file over the years has enabled the IRS to save on its costs of processing returns and to consolidate submission processing operations for individual returns filed on paper into fewer campuses. With Andover, the IRS has now closed four of its previous campus submission processing sites, with one additional campus (in Atlanta) scheduled to stop paper processing in 2011.[10]

Mandatory Electronic Signature on All Individual e-File Returns

Fulfilling a prior recommendation made by TIGTA[11], in 2009 the IRS required all individuals filing self-prepared Form 1040 returns online to use the Self-Select PIN (personal identification number) method to sign their returns, thereby eliminating the prior option to use the paper Form 8453 as the alternative signature vehicle for e-file returns. This step augmented other IRS actions, which had previously mandated taxpayers filing electronically through an e-file provider (typically a paid tax return preparer), to use the Self-Select PIN method. According to TIGTA, the elimination of the paper Form 8453 for e-file signature purposes will reduce IRS submission processing costs and address other significant tax administration problems, such as the issuance of refunds without proper signatures on file.[12]

CADE Release 4

In January 2009, the IRS completed the deployment of Customer Account Data Engine (CADE) Release 4.2, adding additional processing capabilities to this modernized application, which serves as the primary taxpayer account information system for millions of individuals and is intended to eventually replace the individual master file (IMF) system. A key benefit of the CADE system is its ability to process taxpayer account records on a daily basis, and thereby issue associated taxpayer refunds more quickly, compared to taxpayer accounts handled by the legacy IMF system, which is limited to a weekly processing cycle. From January through May 2009, CADE had processed nearly 40 million tax returns (about 30 percent of all individual returns filed) and generated almost $58 billion in refunds. The volume of returns processed by CADE in 2009 represented a sizeable increase over the 30 million returns handled by CADE in 2008.[13]

CADE 2 Refocus

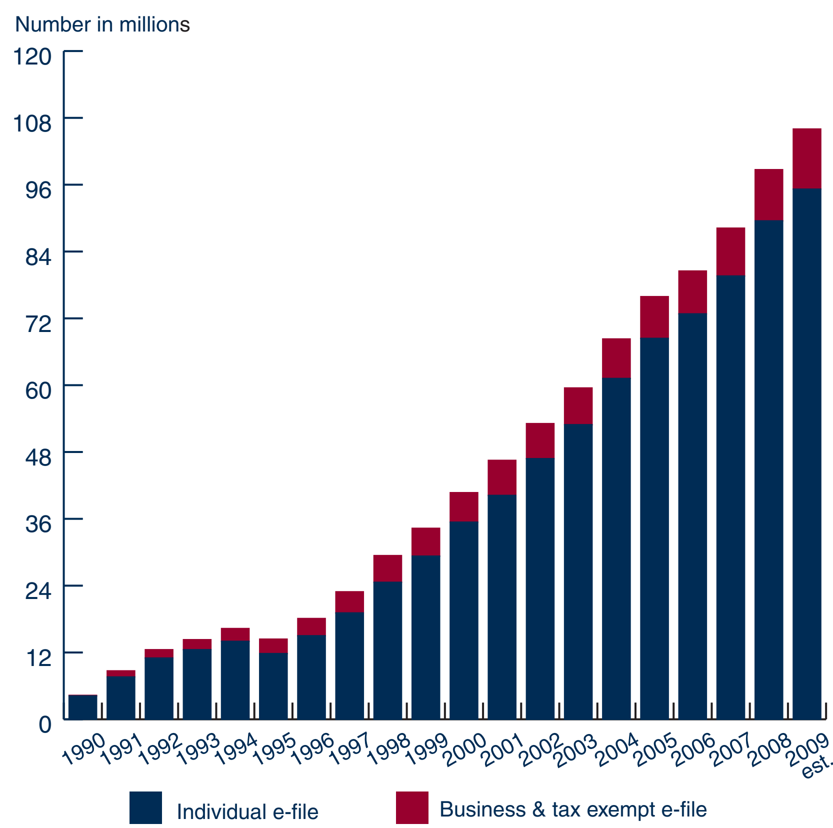
While faster account processing for the nearly 40 million returns handled by CADE in 2009 reflected tangible benefits to many of the affected taxpayers, the IRS recently undertook a detailed review of the CADE program. The review was undertaken because of increasing complexities in system development and questions regarding the scalability of CADE (as more complex returns and account situations are expected to be added to the system). Based on that review, the IRS formulated a new strategy for CADE in 2009, which moves away from the prior incremental "release" approach, and refocuses the project more specifically on modernizing the individual taxpayer database. This new IRS strategy for CADE includes establishing a relational database for taxpayer accounts, populating that database with data from the current IMF and CADE systems, and better addressing financial management and security weaknesses identified by the GAO and TIGTA.[14] The intent of the new IRS strategy for CADE, which the IRS refers to as “CADE 2,” is to achieve a single, modern data structure for its central taxpayer account system for all individual returns, with a daily processing capability, much sooner than would have occurred under the prior incremental “release” approach.[15]

2009 e-File Results and Longer Term Trends in Electronic Filing

Overview: Growth in e-File Continues in 2009, but Still Well Below 80 Percent Goal

The 2009 e-file experience reflects another year of continued progress. In absolute terms, the number of all major individual, business, and tax exempt returns filed electronically in 2009 is estimated to be more than seven million higher than in 2008. From a longer term perspective, the total number of major tax returns filed electronically has grown more than 76 million since the passage of RRA 98, from 29.4 million in 1998 to approximately 106 million in 2009. As illustrated in Figure 4, this growth has occurred every year and has been driven particularly by the electronic filing of individual tax returns, which increased from 24.6 million in 1998 to around 95 million for 2009.

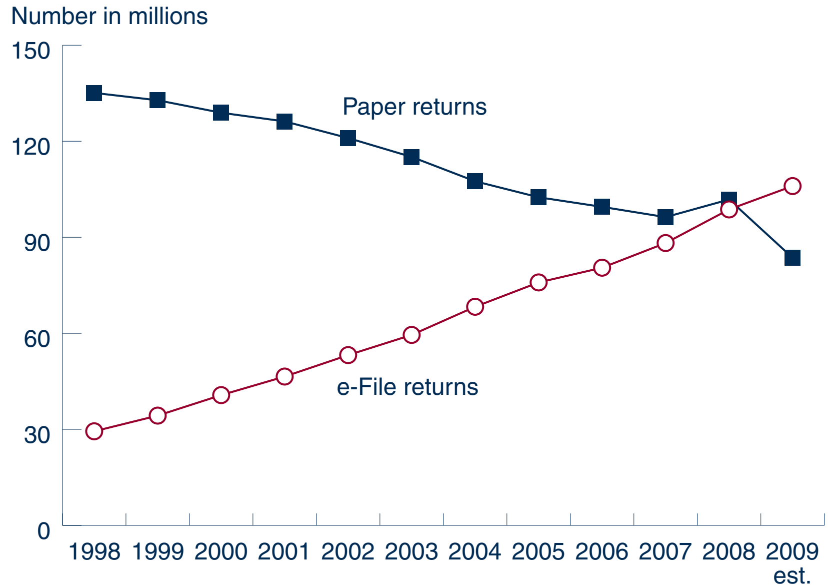
Figure 4. Number of Electronically Filed Returns: Individual and Business & Tax Exempt



Source: IRS with IRS Oversight Board 2009 Estimate

The significant progress in e-file since the passage of RRA 98 is further illustrated by the trends presented in Figure 5. In 1998, the total number of all major tax returns filed on paper was around 135 million, which vastly outnumbered the corresponding volume of e-file returns by a margin of more than 4-to-1. Today, more major tax returns are e-filed than are submitted on paper.

Figure 5. Number of Major Tax Returns: e-Filed versus Paper



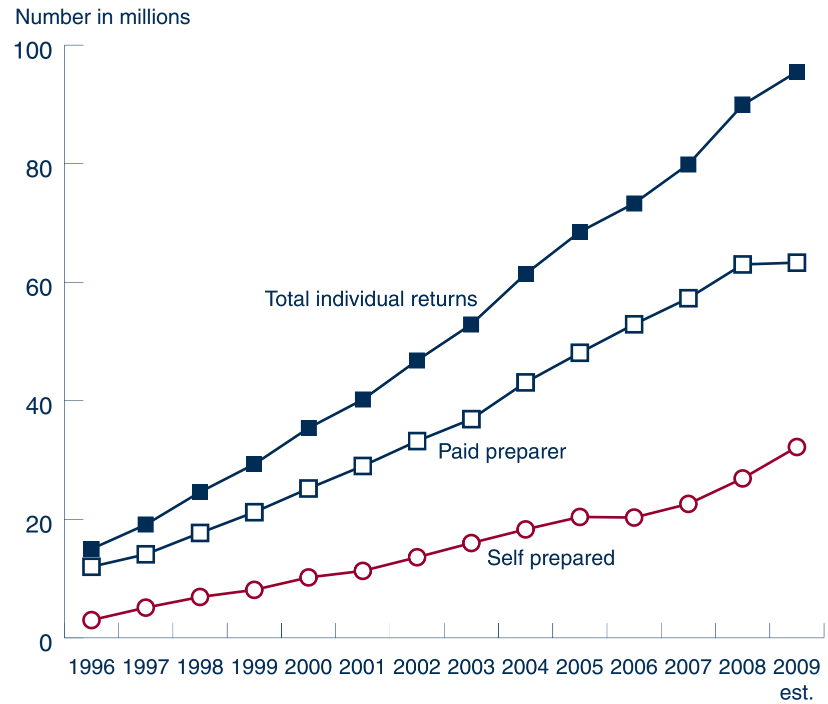
Source: IRS with IRS Oversight Board 2009 Estimate
Note: Return counts for 2008 reflect impact of the one-time only returns filed to claim the economic stimulus payments.

However, despite continued growth in the number of returns filed electronically, the IRS still remains well below the goal of an 80 percent e-file rate for all major tax returns, based on available return filing counts for most of 2009. The IRS has achieved an overall e-file rate of approximately 56 percent for the aggregate of all major tax returns (i.e., for the combination of all major individual, business, and tax exempt returns) during filing year 2009. The e-file rate is around 67 percent for individual income tax returns.

Number of Individual e-File Returns – Total Grows in 2009

Total individual returns filed electronically continued to grow in 2009. As indicated in Figure 6, the IRS will receive around 95 million individual e-file returns during filing year 2009. This reflects growth of around 5.6 million returns over 2008—about a six percent increase.

Figure 6. Number of Individual e-File Returns by Preparation Method



Source: IRS with IRS Oversight Board 2009 Estimate

Impact on e-File Trends Due to Economic Stimulus Act of 2008

The yearly growth in individual e-file in 2009 is noticeably smaller than what occurred in 2008, when the electronic filing volume increased by nearly 10 million returns over 2007, or about 12.5 percent. However, as reported in the Board's e-file report last year, filing trends for individual returns in 2008 were somewhat distorted by a unique one-time event. That unique event, in turn, affects the year-over-year changes in 2009. Specifically, the Economic Stimulus Act of 2008 resulted in the one-time filing of more than 14 million individual tax returns by certain Social Security and veteran benefits recipients, who normally have no reason to file, so that they could receive their economic stimulus payments. While most of the additional individual returns in 2008 associated with the economic stimulus payments were filed on paper, some were filed electronically.

The one-time-only filers in 2008 had the effect of: (a) inflating the year-over-year growth in individual e-file for 2008—as a result of adding more e-file returns to the count than would have occurred in a more normal filing year; and (b) deflating the yearly e-file rate in 2008—as a result of adding a much higher share of returns filed on paper than is typically the case.

Thus, when considering the 2009 e-file results for individual returns, such as presented in Figure 6, it is important to keep in mind that the annual growth in 2009 would have been higher in the absence of the Economic Stimulus Act. Conversely, as will be shown later in this report, the year-over-year change in the individual e-file rate for 2009 appears more pronounced because the 2008 result is somewhat understated. In addition, because individual returns make up the vast major of all major tax returns (i.e., around 75 percent of total returns and approximately 90 percent of e-file returns), the same distorting effects of the Economic Stimulus Act on underlying e-file trends for the 2008-2009 period are present in the data for all major tax returns combined.

Number of Individual e-File Returns by Preparation Method – Only Online Filing Grows Appreciably in 2009

The increase in total individual electronic filing in 2009 is driven almost entirely by the growth in returns submitted "online" by those who self-prepared their returns. In contrast, the number of e-file returns in 2009 submitted through paid tax preparers grew barely at all compared to 2008. These divergent trends are also presented in Figure 6. Their differing trends are likely attributable to several distinct developments.

As indicated in Figure 6, self-prepared returns submitted online grew to approximately 32 million in 2009, up about five million from 2008 (or more than 19 percent). Also, per the discussion above, it is likely this growth in 2009 would have appeared even larger in the absence of the extra e-file returns submitted in 2008 as a result of the economic stimulus payments.

In the view of the Board, there is little doubt that the free federal e-file option newly embedded in the retail tax preparation software sold by two industry leaders contributed significantly to the growth in online filing in 2009.

It is also clear that this growth in 2009 is not attributable to the subset of online filed returns submitted via the free Internet-based e-file options offered by the Free File Alliance. IRS data indicate that the number of Free File returns actually declined, from around 4.7 million in 2008 to only about 3.3 million in 2009.[16]

In contrast to the online filing data, the results presented in Figure 6 further indicate how the number of individual electronic returns submitted through paid preparers (i.e., practitioner e-file) in 2009 was largely unchanged from the year before. Based on the available filing data for 2009, practitioner e-file essentially matched the prior year volume at around 63 million. In percentage terms, the growth in 2009 in practitioner e-file is expected to be only about 0.5 percent. This is in sharp contrast to the prior experience for practitioner e-file, in which the annual growth has been eight percent or higher every year for the past decade.

It is important to note again that part of the reason for the anemic growth in practitioner e-file for 2009 is the result of the extra volume of returns in

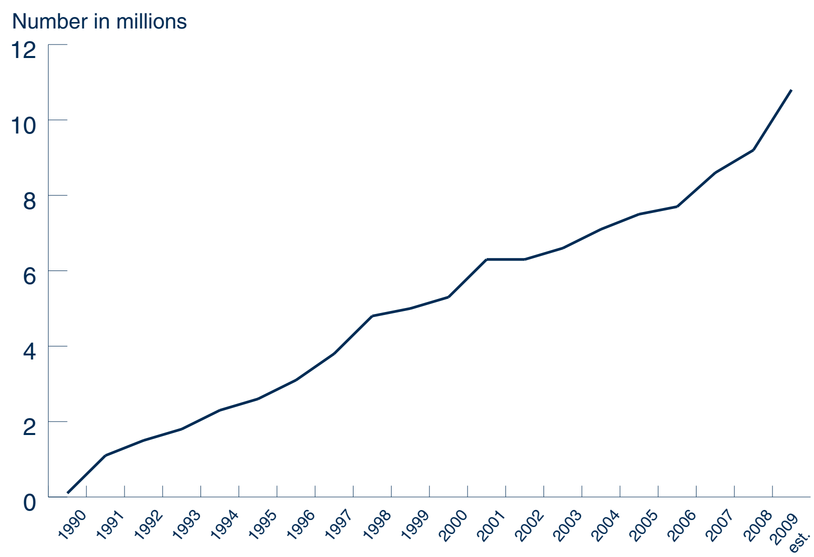
2008 associated with the economic stimulus payments. However, there is also some evidence that a share of taxpayers who normally would have used paid return preparers in 2009 (and thus would have added to the practitioner e-file volume/growth) instead opted to prepare their own returns—presumably to save money during difficult economic times. For example, one newspaper reported two major tax-preparation companies both showed noticeable declines in 2009 in the number of returns they prepared at their retail outlets.[17] In addition, based on its annual survey of taxpayer attitudes, the Board estimates that the total number of individual returns with a paid preparer signature will decline in 2009—a rather rare phenomenon.

In light of these e-file results for individual returns in 2009, a key issue the Board will watch carefully during the next filing season is whether the volume of practitioner e-file returns rebounds in 2010 and resumes its more typical historical upward trend. Without a resumption of the growth in practitioner e-file, it will be much more difficult for the IRS to achieve its overall 80 percent e-file goal by 2012.

Number of Business and Tax Exempt e-File Returns – Both Grow in 2009

The number of major business and tax exempt returns filed electronically also grew in 2009 at a relatively strong pace. As depicted in Figure 7, the combined number of business and tax exempt e-file returns is estimated to reach nearly 11 million in 2009. This reflects growth of around 1.6 million returns, or nearly 18 percent, compared to 2008. This estimated year-over-year percentage growth for 2009 is the highest recorded for the combined total of business and tax exempt e-file since 2001, and well above the growth experienced in the immediately preceding five years, which averaged only 6.7 percent.

Figure 7. Number of Business and Tax Exempt e-File Returns



Source: IRS with IRS Oversight Board 2009 Estimate

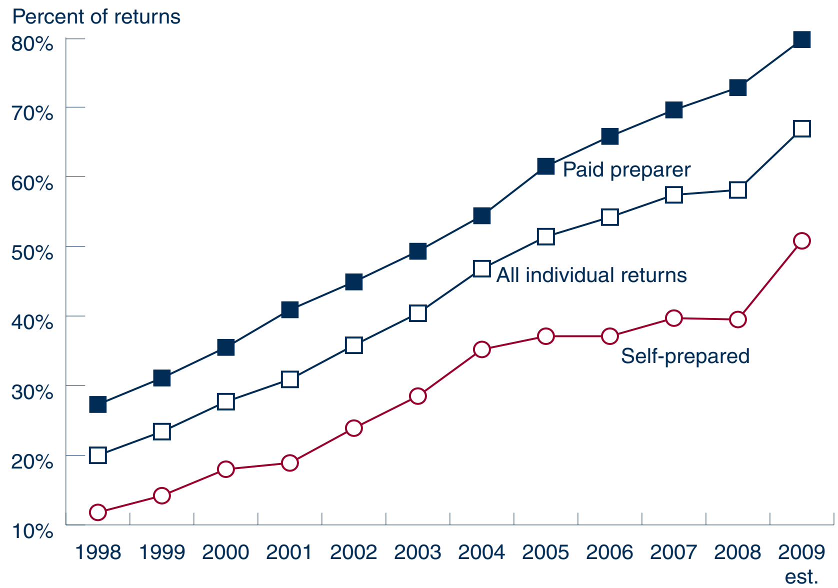
Furthermore, while there are vastly more business e-file returns (e.g., Form 1120, Form 1065, etc.) than tax exempt electronic returns (e.g., Form 990, Form 990-N, etc.), both return series grew noticeably in 2009, based on available data for most of the filing period. In particular, electronically filed business returns are expected to grow to about 10.5 million returns in 2009 from just under nine million in 2008, or about 17 percent. Meanwhile, tax exempt e-file volume is expected to grow around 50 percent, from 225,000 in 2008 to about 338,000 in 2009.

The Board is pleased to see the relatively strong growth in business and tax exempt e-file during 2009, but hopes the IRS can make even greater gains in the future. This is because the e-file rates for business and tax exempt returns, even with the strong e-file growth in 2009, still lag far behind the comparable rates for individual returns. Further discussion about the contrasting e-file participation rates for business and tax exempt returns versus individual returns, and the opportunities and challenges they present, is provided later in this report.

Percent of Individual Returns Filed Electronically – e-File Rates Grow in 2009

Figure 8 presents an historical view of the percentage of returns filed electronically for individuals in total. It also contains the individual e-file rate trends broken out by filings submitted online by taxpayers who self-prepared their returns versus the practitioner e-file returns submitted through paid preparers. The results in Figure 8 reveal encouraging patterns with all three trend lines showing solid growth in 2009 in terms of the percentage of individual returns filed electronically.

Figure 8. Percent of Individual Returns Filed Electronically by Preparation Method



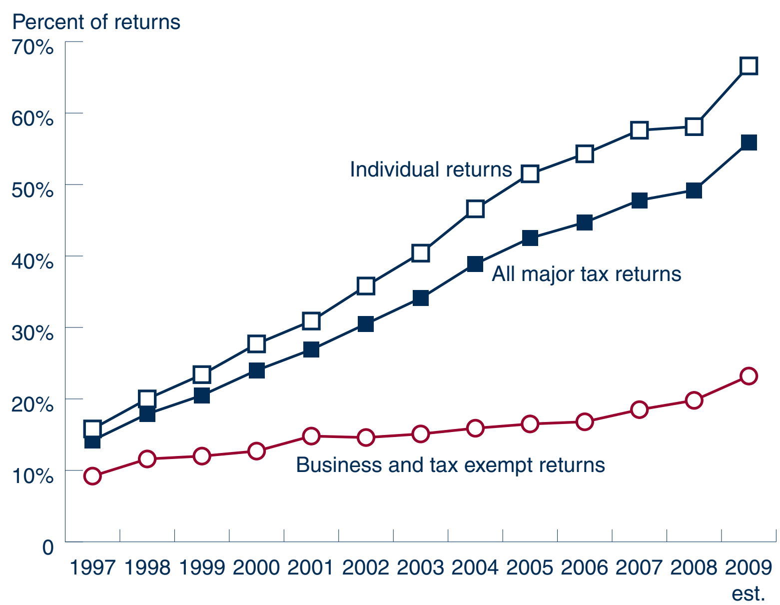
Source: IRS with IRS Oversight Board 2009 Estimate

In particular, the e-file rate for all individual returns grew from about 58 percent in 2008 to nearly 67 percent in 2009. The e-file rate among individual filings submitted through paid preparers grew to nearly 80 percent in 2009, up from just under 73 percent in 2008. Meanwhile, the percent of self-prepared returns filed electronically jumped from around 40 percent in 2008 to about 51 percent in 2009. This increase reflects the impact of embedding the free federal e-file option into two of the major retail tax preparation software packages in 2009. The relatively strong increase in the e-file rate for self-prepared returns is particularly encouraging, given that the rate had appeared to reach a plateau (in the high-30 percent range) over the prior five-year period with hardly any upward movement. However, it is again important to note that some of the growth in the e-file rates in 2009 for self-prepared returns, for paid preparer returns, and for individual returns in total, is attributable to the impact of the economic stimulus payments that serve to deflate the 2008 e-file rates.

e-File Rates for Business and Tax Exempt Returns Grow in 2009

Figure 9 presents a comparison of three more long-term e-file participation rate trends through the year 2009. These trends reflect the percent of returns filed electronically for all individual returns, for business and tax exempt returns, and for all major tax returns combined. While the 2009 results are estimates based on partial year filing data, they nevertheless point toward continued progress in increasing the share of all returns filed electronically.

Figure 9. Percent of Major Tax Returns Filed Electronically



Source: IRS with IRS Oversight Board 2009 Estimate

As indicated in Figure 9, the e-file rate for business and tax exempt returns grew from just under 20 percent in 2008 to a little over 23 percent in 2009. This is a net increase of about three percentage points in the e-file rate for business and tax exempt returns and is the largest such increase recorded in over a decade. As was stated earlier, the Board is pleased to see the stronger growth in business and tax exempt e-file in 2009, and views this more substantial increase in the respective e-file rate as a promising sign of progress. Also, because individual returns comprise around three-quarters of all major tax returns[18], and because the percentage of returns filed electronically by individuals is substantially higher than for businesses and tax exempt entities, the e-file rate for the combined total of all major tax returns in 2009 is approximately 56 percent, as illustrated in Figure 9.

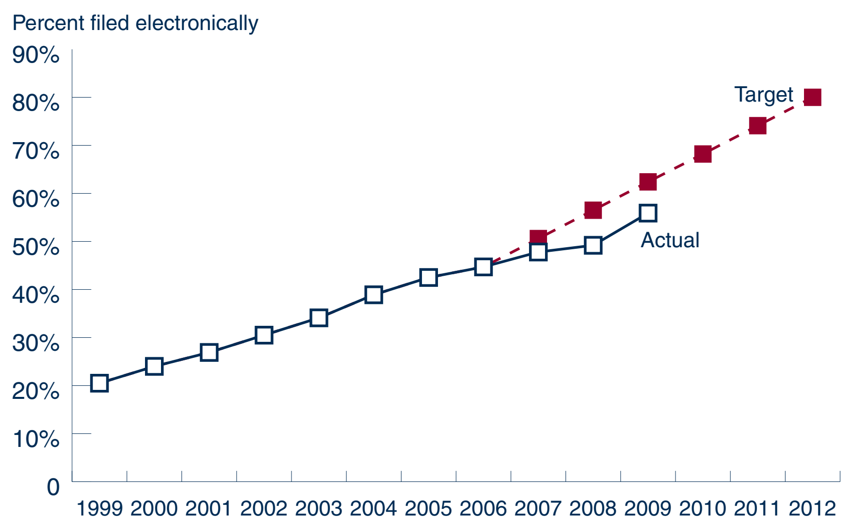
Looking back to when RRA 98 was enacted, the e-file rate for individual returns has grown from 20 percent in 1998 to about 67 percent in 2009. For business and tax exempt returns, the respective e-file rate has gone from 11.6 percent to about 23 percent. The corresponding e-file rate for all major tax returns combined has gone from just under 18 percent to around 56 percent. The Board views these increases in the shares of returns filed electronically to be a clear sign of progress, largely attributable to the challenging 80 percent e-file goal specified in RRA 98 and to the continued interest of policymakers in monitoring how well the IRS is doing in advancing toward that goal.

Tracking Progress on the 80 Percent e-File Goal

Overall e-File Rate Continues to Grow But Will Not Reach 80 Percent Goal by 2012 at Current Pace

Considering the e-file trend data through 2009, it is clear that each year a greater share of individual, business, and exempt organization taxpayers avail themselves of the benefits of electronic filing. Nevertheless, with only around 56 percent of all major tax returns filed electronically in 2009, the IRS still has a very steep hill to climb to reach the goal of an 80 percent e-file rate by 2012—now only three years away. In fact, the Board has been tracking the progress of the IRS since the agency recommitted itself to the 80 percent e-file goal based on all major tax returns. The Board's trend analysis is presented in Figure 10 and indicates that if the current trend continues, the IRS will fall short of the 2012 e-file goal.

Figure 10. e-File Rate for All Major Tax Returns Combined: Actual vs. Target



Source: IRS and IRS Oversight Board Analysis

Using 2012 as the target date for reaching the 80 percent e-file level and 2006 as the base point for measuring progress, Figure 9 presents the linear trend line for e-file participation for the years 2007 through 2012 needed to attain a steady progression toward the 80 percent goal. The base year of 2006 was selected to measure progress as it reflects the last year of actual e-file experience prior to the Board approving the long-term measure recommitting the agency to the 80 percent goal.

The results in Figure 10 indicate that the actual 2009 e-file participation rate for all major returns combined is around 6.5 percentage points below the targeted level, i.e., a target of 62.4 percent, versus an actual of around 55.9 percent. Also, setting aside the result for 2008 because of the distorting effect of the one-time only returns associated with economic stimulus payments, Figure 10 indicates that the gap between the target value and the actual e-file experience has more than doubled since 2007, when it stood at only 2.8 net percentage points below the target. Extrapolating the e-file rate for all major tax returns to the year 2012, based on the underlying rate of growth experienced over the 1997 2009 period, indicates that the actual value will only reach an overall e-file rate of around 66 percent—or about 14 net percentage points below the 80 percent goal by the target year. In addition, the newly-enacted federal e-file mandate for individual return preparers will help to close some of that 14 point gap. However, the mandate alone will not be enough to attain the goal.

The Board still believes the 80 percent e-file goal by 2012 is achievable. However, reaching that goal will require additional substantive actions in the very near future by the IRS, the professional tax community, and policymakers. Certainly the new federal e-file mandate for preparers of individual returns will provide a strong boost toward the 80 percent goal. The Board is hopeful that the IRS' *Advancing e-File Phase 2 Study* will provide an effective strategy to guide IRS actions and substantially increase e-file participation. In addition, as is discussed in more detail in the following section, actions that can lead to attainment of the 80 percent e-file goal by 2012 must take into consideration some key characteristics about the remaining segments of returns still filed on paper, and their associated e-file rates.

Key Considerations in Strategies to Reach 80 Percent e-File Goal

IRS Needs to Convert 46 Million Paper Returns to e-File to Reach 80 Percent Goal

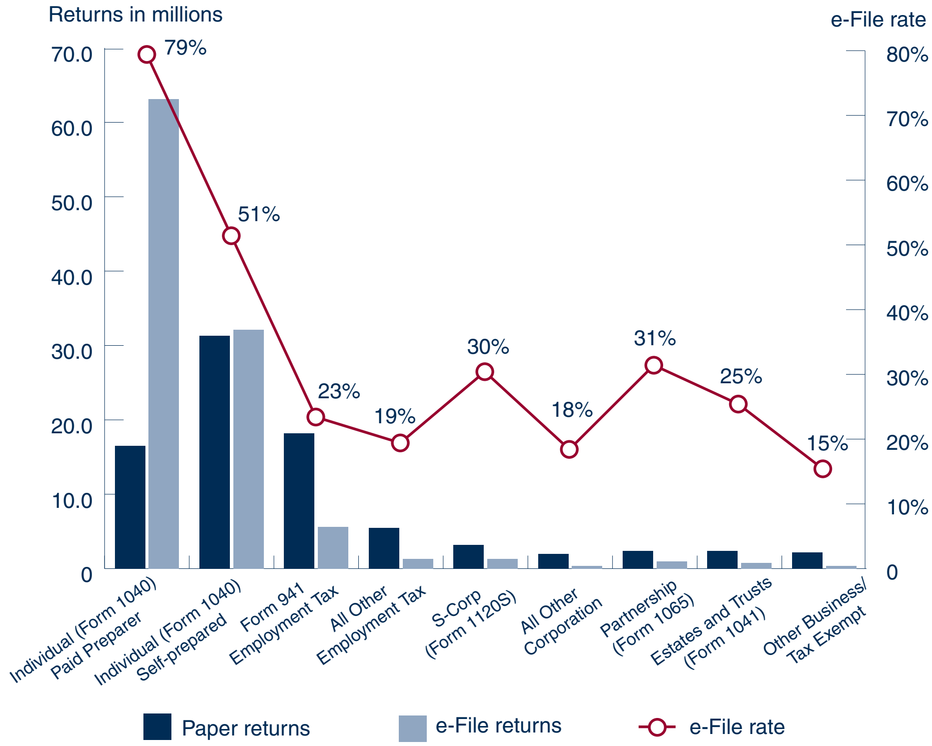
Based on 2009 return filings, the IRS needs to convert approximately 46 million paper tax returns filed by individuals, businesses, and tax exempt organizations to e-file to reach the 80 percent goal. Currently there are approximately 48 million individual returns still filed on paper and another 37 million paper-filed business and tax exempt returns. The IRS could attempt to reach the 80 percent e-file goal by focusing exclusively on individual tax returns. However, that would require achieving a nearly 99 percent e-file rate for all individual returns, which is not a realistic scenario. A more sensible strategy is one focused on increased e-file by individuals, businesses, and tax exempt organizations. In addition, closer consideration of the data reveals that three specific segments of returns, in particular, are the key to reaching the e-file goal.

Focus on the Three Segments of Returns Where Paper Volumes are the Largest

Figure 11 shows that three segments of returns comprise nearly 80 percent of the return submissions still filed on paper: individual returns submitted through tax return preparers; individual returns filed by those who self-prepare their taxes; and Form 941 employment tax returns. In particular, based on 2009 volumes, around 16.5 million paper individual returns originate from return preparers; around 31.5 million paper individual returns are from self-preparers; and around 18 million paper returns reflect the quarterly Forms 941 filed by employers. Figure 11 also reveals that e-file participation rates for self-prepared individual returns (i.e., 51 percent) and Form 941 employment returns (23 percent) lag far behind those for paid preparer individual returns (79 percent).

The recently enacted federal e-file mandate for preparers of individual returns provides an effective strategy for significantly increasing the volumes of e-file returns from one of the three segments that are key to achieving the 80 percent goal—provided that the IRS delivers a smooth implementation of that preparer mandate. As a consequence, the core remaining challenge to the IRS and partners in the professional tax community is to identify the additional strategies that can significantly increase the e-file participation rate among those individuals who self-prepare their returns and among employers filing Form 941.

Figure 11. Number of Paper vs. e-File Returns by Major Return Type and Respective e-File Rates - Estimated Filings in 2009



Source: IRS Oversight Board Estimate Based on Partial Year IRS Data

e-File Mandate for Preparers Addresses One Key Segment If Effectively Implemented

The newly-enacted preparer e-file mandate at the federal level should prove very successful in converting to e-file a large share of the remaining paper individual returns submitted through return preparers. As the data in Figure 11 indicate, perhaps as many as 16 million additional paper returns might be converted to e-file from the new mandate.

Based on 2009 filings, had such a federal e-file mandate been in place and had the effect of converting roughly 16 million more returns to e-file, it would have raised the overall e-file rate for all major tax returns to approximately 65 percent. Such an e-file rate would be nine net percentage points higher than the roughly 56 percent overall e-file rate actually achieved in 2009. However, the e-file mandate does include an exemption for very low-volume return preparers (i.e., 10 returns or fewer) and is not likely to convert all the remaining preparer returns to e-file. Still, data from the Board's 2006 report suggest that the new e-file mandate for preparers will apply to at least three-quarters of the current pool of paper-filed preparer returns—making it a highly effective strategy to significantly increase e-file volumes and move the IRS much closer to the 80 percent goal.

In addition, success also requires that the IRS effectively implement that mandate; a challenge that is complicated by the phased implementation of the new Form 1040 MeF application. In particular, while the federal e-file mandate for preparers is effective for tax year 2010 individual returns filed in 2011, the IRS does not plan to deliver the third and final phase of its new Form 1040 MeF application until filing year 2012. Thus, the IRS will need to work closely with return preparers and the tax software industry, and exercise as much flexibility as possible, to minimize the burdens on its tax partners associated with implementation of the e-file mandate during the 2011 period. Still, the Board also believes that the burden on the preparer community from the new e-file mandate will ultimately prove manageable given their high e-file participation rate and because virtually all individual tax returns from preparers are already prepared using tax software with only a few rare exceptions.[19]

Further Efforts Needed That Target Self-Prepared Individual Returns Filed on Paper

While the federal e-file mandate for individual return preparers will significantly increase e-file volumes, the data in Figure 11 also show that the mandate alone will not achieve the 80 percent goal. At best, the e-file mandate for individual return preparers can only deliver around 16 million of the approximately 46 million additional e-file returns required to reach the goal. Consequently, it is important to recognize the need for additional strategies to raise the e-file rate among individual taxpayers who self-prepare their returns, given that this specific taxpayer segment currently files the most returns on paper (nearly 32 million).

As shown in Figure 11, a little over half of all individual self-preparers elected to e-file in 2009. This reveals that a sizable number of individuals remains unconvinced as to the benefits of e-file, and presents both a challenge and an opportunity for the IRS and its tax partners. The opportunity arises in part from other data indicating the extent to which this segment of filers consists of what the IRS labels “V-coded” returns. V-coded returns are returns filed on paper despite being computer generated from tax preparation software. Based on IRS data, the Board estimates that at least 11 million of the 32 million self- prepared returns filed on paper are V-coded returns.

The action by two industry leaders to offer free e-file for federal returns as part of their retail tax preparation software in 2009 was a major step in the right direction in terms of an effective strategy to increase e-file among individuals who self-prepare their returns on a computer but file on paper. As noted earlier in this report, this action provided a significant boost to the e-file rate among self-preparers compared to the immediate prior years. Still, the IRS and its tax partners must pursue additional strategies that encourage even more of these self-preparers to take advantage of the free federal e-file option within their tax software.

The IRS and industry also need to continue to explore other creative ideas, as they did in 2009 with the Free Fillable Form initiative, to further encourage the use of e-file by individuals who prepare their own returns. The Board is pleased to note several additional steps in that regard. In particular, the IRS has reached a new agreement in November 2009 with the Free File Alliance that continues to make free tax preparation of federal returns available to a large segment of individual taxpayers.[20] That agreement also includes a few new features, such as a link to comparable free online e-file options for state tax returns, which will provide additional incentives for considering the use of Free File. In addition, the Board looks forward to the release of the IRS' *Advancing e-File Phase 2 Study* with the expectation that it will identify yet other innovative steps targeted at individuals who self-prepare their returns.

The Importance of Getting More Employers to e-File Forms 941

As Figure 11 reveals, far smaller shares of business and tax exempt returns are currently filed electronically compared to either paid preparer or self-prepared individual returns. In addition, because such a large number of Form 941 returns are filed on paper, increasing e-file among this segment of returns is crucial to achieving the 80 percent goal. In general, Form 941 employment tax returns are filed quarterly by employers, both for-profit businesses and not-for-profit tax exempt organizations, to report their liabilities for Social Security and Medicare taxes, and for federal income taxes withheld from employee wages, where the total of those liabilities exceeds $1,000 per year.

The data in Figure 11 indicate that less than a quarter of Forms 941 are currently e-filed. As a result, around 18 million paper Forms 941 will be filed during 2009. Clearly, more needs to be done to increase the share of these employment returns filed electronically if the 80 percent e-file goal is to be attained. It is also important to note that given that Form 941 is usually filed quarterly, success in converting one employer from paper to e-file typically translates into four electronic Form 941 returns.

The Board recognizes that the IRS and its tax partners have made various attempts over the years to advance Form 941 e-file volumes. For example, the IRS once offered employers a free e-file option based on touch-tone telephone technology (i.e., Form 941-TEL). The IRS also made Form 941 one of the first IRS e-file applications to be built on the more flexible, industry-standard "XML" software. Meanwhile, payroll service companies and tax preparation software businesses have and continue to offer an array of services to meet the payroll needs of employers, including options for e-filing Forms 941 and other tax returns and information documents.

Still, with a current e-file rate of only 23 percent, it is evident that the IRS and industry efforts to date have had only limited success in moving employers away from paper Form 941 returns to e-file. The Board notes that the ETAAC made several recommendations in its *2008 Report to Congress* designed to increase the e-file rate for Form 941 returns in particular. These recommendations included the idea of the IRS deploying a free Internet-based application for employers to e-file their

Form 941 returns and for legislation that would mandate electronic filing of Forms 941 for those employers already required to file their Forms W-2 electronically. While those prior ETAAC recommendations were not mentioned in their 2009 report, the Board believes they still merit consideration. The Board also encourages the IRS and tax professionals to develop other strategies directed specifically at increasing the e-file rate for Form 941 and other employment returns, given their potential to move the IRS substantially closer to the 80 percent e-file goal. However, the Board also believes that e-file and other ETA requirements placed on businesses and employers need to be considered in a more strategic fashion, and not the piecemeal approach that has typically been the case.

Need for a Strategic View for Increasing e-File Among Businesses and Employers

As the Board has noted in its prior two reports to Congress on e-file, much of the current ETA-related requirements for business and employers are a patchwork of mandates with only limited effectiveness. Aside from electronic transmission requirements on filers of information and withholding documents and those on tax exempt organizations required to file Form 990-N, most other e-file mandates for businesses, employers and tax exempt entities are of very limited effectiveness in terms of generating any significant volume of e-file returns. For example, while mandates are in place for partnership Form 1065, corporation Forms 1120 and 1120S, excise tax Form 2290, and exempt organization Form 990 returns, none have contributed to noticeable impact on the respective e-file rates—as is apparent from the results presented in Figure 11. Indeed, the e-file participation rates for business, employment, and tax exempt returns are almost entirely the result of taxpayers voluntarily electing to e-file.

As a result, the Board reiterates its view that the IRS and policymakers need to act in a more strategic fashion in determining appropriate changes to e-file and other ETA-related requirements in the business, exempt organization, and employment tax areas in the future. That approach should consider the suggestions made in prior ETAAC reports and IRS budget submissions, but in a comprehensive manner. Such a strategic approach should carefully consider the filing requirements of all the major business, employment, and tax exempt returns, and the other tax requirements associated with those returns, such as deposits and information document submissions; gauge the marginal impacts of various alternative mandate requirements and the burdens they would impose; and arrive at a corresponding set of proposed legislative and regulatory changes that further the e-file goal and the broader ETA vision. That approach also needs to look beyond just the impact on e-file participation rates and base any revised e-file mandates on how the increased data in electronic form would be leveraged to improve service and tax compliance.

Higher e-File Participation Among All Major Form Types Also Important

While the Board's analysis points to the key role that individual Form 1040 and employment Form 941 returns play in striving to meet the 80 percent e-file goal, it still must remain a priority of the IRS to also increase electronic filing among all major return types. This is because the benefits and opportunities created by more electronic filing vary by form type. For example, the processing costs savings to the IRS from converting certain types of business and tax exempt returns from paper filed to e-file can be more substantial than with individual returns. As an illustration, TIGTA has reported that the estimated IRS processing cost savings from individual e-file is around $2.50 per return,[21] while data on business returns reported to the Office of Management and Budget indicate IRS cost savings of $4.37 for each Form 990 converted from paper to electronic.[22]

It is also possible to envision a much more sophisticated and effective IRS compliance program if significantly more of the "flow through entity" information on gains and losses reported on partnership (Form 1065) and S-Corporation (Form 1120S) returns were received electronically. Thus, while the Board is encouraging IRS and its tax partners to devote particular attention to individual and employment tax returns in pursuit of achieving the 80 percent e-file goal by 2012, the Board also recognizes that attention must be given to all.

Challenges to Achieving the Vision for Electronic Tax Administration

Despite the progress toward the 80 percent goal and other e-file advancements since the passage of RRA 98, such as the many MeF applications implemented in the business and tax exempt return areas[23], the federal tax administration environment of today is still a far cry from the full ETA vision. Major challenges must still be overcome to achieve the vision in which the vast majority of tax interactions are handled electronically. Some of the major challenges to achieving a truly modern ETA environment that are of particular concern to the Board are noted below.

The IRS Is Still Tied to Weekly Master File Processing

The IRS is handicapped in achieving its ETA vision in part because it must continue to rely upon its old master file systems for several years to come. These systems limit more effective uses of tax administration data because they do not use modern "relational" database structures and because they provide only weekly account updates. Even under the new strategy the IRS has articulated for CADE 2, weekly processing will remain the norm for at least another two years. Furthermore, plans for CADE have yet to address in any substantive form the issue of a daily processing capability for the business master file.

Modernized e-File Platform for Form 1040 Will Take Years to Complete

Another handicap to achieving the full ETA vision arises from the timeline for replacing the decades-old e-file system for individual Form 1040 series returns. According to its implementation timeline, the IRS plans to deliver its new Form 1040 MeF platform in a three-phase process. The roll-out will start with the capability to process a certain set of core individual returns (and schedules) during the 2010 filing season and then eventually progress to the accommodation of all individual returns by the 2012 season.[24]

Compared to the current legacy e-file technology for individual returns, the Form 1040 MeF platform promises to provide a much more flexible system—enabling the IRS to receive and process returns in an Internet format, provide real-time processing of e-file acknowledgements, and streamline error detection. The Form 1040 MeF application will also give taxpayers the capability to attach PDF documents, accommodate year-round processing, and for the first time, enable the electronic filing of amended individual income tax returns. The eventual delivery of an e-file capability for amended individual returns is particularly important because the Board has long heard many complaints from practitioners that the IRS has continued to burden taxpayers with erroneous balance due notices and other demands for payments, while the amended returns that would resolve the issues sit unprocessed at IRS campus facilities handling paper returns.

However, while the Form 1040 MeF application should induce even greater e-file participation and provide better service to individual taxpayers, the three-year phase-in delays the day that taxpayers, tax professionals, and the IRS will have the full benefits of a modern e-file system for individual returns. In addition, because of the phased approach to Form 1040 MeF, the IRS and its tax partners may face additional burdens from the complications of attempting to implement the new federal e-file mandate for individual return preparers in 2011. In that year, some individual returns will still need to be transmitted through the old legacy e-file system.

Business Systems Modernization Is Regularly Underfunded

The challenge to IRS achieving its broader ETA vision as a result of the slow pace of replacing its master file systems and rolling out its new Form 1040 MeF application is tied to a more fundamental barrier—the continued underfunding of the IRS Business Systems Modernization (BSM) program. As the Board noted in its *2008 Annual Report to Congress*, year after year, funding to modernize IRS' technology is scaled back to the lowest possible levels. This limits BSM projects, such as the replacement of the master files and MeF systems, to only modest progress at best. Since the Board's inception, it has advocated that the IRS' BSM program be funded at a higher level so progress could be made more quickly. Yet, for the past seven fiscal years, the annual BSM budgets provided to the IRS have averaged only around 60 percent of the amounts recommended by the Board.

Dangers of Identity Theft

The potential for identity theft raises still more difficulties for the IRS to achieve its goals of a secure and smooth-flowing electronic tax administration environment. E-mail scams and other Internet-based criminal activities designed to trick taxpayers into revealing personal and financial information frequently masquerade as official IRS communications. The IRS cites industry sources that show the IRS is one of the most "spoofed" brands (organizational entities) in the world.[25] Consequently, the IRS must regularly advise taxpayers on the dangers of identity theft and the means to avoid it; build applications and take other actions that thwart the efforts of would-be identity thieves; and implement IRS practices and procedures that responsively serve those taxpayers who are victimized. Meanwhile, the danger of identity theft discourages some taxpayers from considering e-file and the prospect of engaging in other electronic tax interactions, posing still more challenges to the ETA vision.

Termination of the My IRS Account Project and Lack of an Enterprise-wide Electronic Authentication Solution

As reported by TIGTA[26], in early FY2009, the IRS decided to terminate the scheduled implementation of an important ETA prototype initiative called the "My IRS Account" project. The intent of the project was to develop a system that would provide taxpayers a means to securely view their tax account information online, as well as provide tools for self-service assistance. It was also intended to serve as a prototype for future delivery of new web-based IRS projects. However, the IRS decided to terminate the application's deployment and instead reexamine whether the new system fully met both the taxpayer and IRS strategic needs.

In addition, TIGTA further reported that the My IRS Account application is based on an interim solution to the matter of electronic authentication (i.e., ensuring the individual performing the electronic transaction is authorized to do so). However, TIGTA emphasizes that the IRS needs to develop and deploy a strategy for an enterprise-wide electronic authentication solution so that other online projects that require secure online access can be deployed more expeditiously than was the case with My IRS Account.

The Board understands the need for the IRS to reconsider whether the My IRS Account application is consistent with the strategic goals and priorities articulated in its newly revised *IRS Strategic Plan 2009-2013* and worth the associated IT resources needed to deploy and maintain the system. The Board also understands how an enterprise-wide solution to electronic authentication is a critical part of a long-term strategy for delivering new online services to taxpayers. Nevertheless, these issues present yet more challenges to achieving the ETA vision. The ability of taxpayers to review their tax account electronically was a capability explicitly called for in RRA 98, and the Board remains convinced that it is a foundational part of a modern ETA system in which taxpayers can research and resolve their account issues online. The Board encourages the IRS to make the reexamination of the My IRS Account project and this issue of enterprise-wide electronic authentication a top priority.

Rising to the Challenge

The challenges the IRS and the professional tax community face in achieving the vision for electronic tax administration are real and significant. However, it is the Board's view that the IRS can meet those challenges with the proper support of its tax partners in the private sector and policymakers in the Administration and Congress. The recent tax law change establishing an e-file mandate for preparers of individual returns, the decision by two major producers of consumer tax preparation software to no longer charge a fee to electronically file an individual federal tax return, and the successful IRS delivery of major MeF systems demonstrate quite clearly how committed all the key institutions are to achieving the 80 percent e-file goal and the larger vision of a modern tax administration system; a system that serves America's taxpayers better and reduces the administrative burdens placed on them.

The Board commends policymakers, the professional tax community, and the IRS for these substantive actions to date and encourages all parties to continue to pursue other promising avenues to advance the ETA vision. The recommendations put forth by the ETAAC in its *2009 Report to Congress* contain other thoughtful ideas and suggestions to advance the ETA vision. The Board supports a number of these recommendations and offers its comments on key ETAAC suggestions in the following section.

Comments on Key Recommendations from the Electronic Tax Administration Advisory Committee

The 2009 ETAAC report to Congress offers several thoughtful recommendations to further increase e-file participation and advance the ETA vision. The Board finds merit in many of these suggestions and commends ETAAC members for their innovative thinking. As for particular ETAAC recommendations, the Board also offers the following comments.

e-File Mandate for Form 1040 Paid Preparers

The ETAAC's 2009 report recommended that Congress grant the IRS the authority to require certain tax preparers of individual returns to e-file. The Congress and President have since acted through the Worker, Homeownership, and Business Assistance Act of 2009 (*P.L. 111-92*) to establish such an e-file mandate. The Board is pleased to see that this legislation, which the ETAAC has long championed and that the Board has supported, has now become law. However, as noted earlier, the Board also encourages the IRS to implement this mandate in a well-coordinated and flexible fashion to minimize burden on the preparer and tax software communities. This is particularly the case in light of the mandate's effective date, which precedes delivery of the full Form 1040 MeF capability, and also because of the relatively low mandate threshold, i.e., preparers filing more than ten returns.

Funding and Management to Complete the Four Pillars of Modernization

The ETAAC recommends that Congress provide the necessary budget resources, and that the IRS devote the necessary management capacity, to complete the "four pillars" of its BSM effort. These four pillars are: Modernized e-File (MeF); Customer Account Data Engine (CADE)[27]; Account Management Services (AMS); and the Data Strategy. As noted by TIGTA, successful implementation of these four pillars is essential to the support of all tax administration activities and is critical to the long-term success of the overall BSM program.[28]

The Board agrees with the ETAAC that it is critically important that the IRS successfully complete the major components of the IRS' information technology modernization program. As noted in the earlier section on challenges facing the ETA vision, the Board remains concerned about the regular underfunding of the annual budgets for BSM and encourages policymakers to provide the needed resources that would enable the IRS to build the technological infrastructure for a modern tax administration system. The Board also believes ETAAC is correct in further emphasizing that the IRS, in turn, must ensure it devotes the necessary management attention to deliver on BSM components within reasonable cost and schedule targets.

Comprehensive Data Strategy

The Data Strategy refers to a coordinated series of programs and projects that comprise a comprehensive plan for IRS data collection, consolidation, storage, and distribution. The ETAAC notes that virtually every tax administration function involves data management, yet the IRS continues to operate without an effective data strategy articulating the infrastructure, roadmap, and rules for IRS data management. The ETAAC makes a series of recommendations to help establish such a comprehensive IRS data strategy focused on collaboration with stakeholders, data definitions, data governance, authentication, and e-signatures. The Board agrees with the ETAAC about the need to view IRS data as a strategic tax administration resource, and to plan and manage its use in a comprehensive fashion.

Plan to Modernize e-Services

The ETAAC states that the current e-Services program that provides authorized preparers electronic access to certain IRS tools and services (used to resolve taxpayer account issues) is facing the end of its system “life-cycle.” As a result, the ETAAC makes several related recommendations for various enhancements to that portfolio of services, in conjunction with the IRS’ move to a more current software application platform for e-Services. ETAAC emphasizes that tax preparers should be provided with a modern set of self-service tools that make their interactions with the IRS easy and convenient. The Board fully agrees with these ETAAC recommendations concerning e-Services. The majority of tax returns are typically filed with the aid of a professional tax return preparer and the Board appreciates the key role these private sector professionals play in ensuring a well-functioning tax administration system. Therefore, it is important that the IRS maintain and enhance its portfolio of e-Services to tax professionals if it hopes to achieve the broader ETA vision.

e-Strategy Development and Implementation as an Enterprise Priority

The ETAAC notes that the IRS has recently ceased working on major Internet-based applications due to uncertainty about the technical environment in which these planned applications would operate or because a clear taxpayer need had not been established. An example would include the decision not to deploy the My IRS Account project, as discussed earlier in this report. To address these problems, the ETAAC makes several recommendations relating to project priority governance, taxpayer and tax preparer need assessment, and supportable IT architecture. These recommendations are intended to establish an enterprise (i.e. IRS-wide) strategy for development and implementation of major IRS web applications in the future. The ETAAC further argues that an IRS “e-strategy” for its Internet applications will not be effective unless it is supported and governed as an enterprise.

The shortcomings and recommendations identified by the ETAAC in this area are very much in keeping with those presented in a TIGTA report released in May 2009.[29] The Board believes these ETAAC recommendations are sensible and reflect a strategic approach to delivering IRS’ Web-based services, which are key to achieving the ETA vision.

Standards for Tax Software Services

The ETAAC recommends that the IRS work with the tax preparation industry and the States to set high industry standards and determine the best model for the efficient and effective oversight of tax software services. The ETAAC further notes that this collaboration to establish the proper standards for software services will be critical to protecting the e-file customer base. The particular areas where the ETAAC recommends IRS collaboration with industry are on clearer security and software accuracy standards.

There is little doubt that tax preparation software is an integral part of the tax administration environment of today. IRS data suggest that at least 86 percent of all individual Form 1040 series returns filed during 2009 were prepared using tax software.[30] Such software plays a similarly dominate role in the preparation of major business and exempt organization tax returns. In addition, the GAO reported that the IRS does not fully monitor compliance with established security and privacy standards by the tax software industry, and that the IRS further needs to more carefully assess the risks and opportunities associated with tax software.[31]

In keeping with the GAO recommendations, the IRS has noted that part of its 2009 review of the tax return preparer community would include consideration of greater IRS regulation of tax software.[32] The goals of those recommendations will be to increase taxpayer compliance and ensure uniform and ethical standards of conduct for tax preparers.

The Board supports the ETAAC recommendations calling for improved IRS collaboration with industry to ensure clear security and privacy protection standards. The Board also agrees that the IRS should work with industry as closely as possible to help tax software producers to ensure the accuracy of their products, such as by promptly sharing information of the types of errors the IRS is uncovering on returns. However, the Board also believes the IRS must be realistic about the role it can sensibly play, in a “pre-filing” context, to ensure the accuracy of tax software produced by private industry and that the IRS not attempt to take on any role that entails “certifying” the accuracy of commercial tax software.

Renewal of the Free File Alliance Program

The ETAAC notes that the IRS contract with the Free File Alliance makes possible the Free File program in which 70 percent of all individual taxpayers are eligible to use online, full-featured interview tax preparation and e-file software for free. This agreement with the Free File Alliance also made possible the 2009 fillable forms service that enabled all individual taxpayers, regardless of income, to enter their federal tax return data and e-file for free. Consequently, the ETAAC recommended that the Free File Alliance agreement, which was nearing its expiration, be extended along with some selected improvements. In doing so, the ETAAC further argues that the Free File Alliance has established an important free model that drives more competitive choices for taxpayers.

As noted earlier in the report, the IRS has since announced that it has renewed its agreement with the Free File Alliance, adding a few new features in the process. The Board supports the decision of the IRS and Free File Alliance members to renew the program and commends all parties for their commitment to this unique public-private arrangement. The Board agrees with the arguments in favor of the program put forth by the ETAAC, particularly that it had met the e-file needs of over three million filers in 2009, and that it fosters competition to create even more e-file choices for taxpayers.

Improvements with Respect to Rejected e-File Returns and Sharing Information Return Data with States

The ETAAC offered several other thoughtful recommendations to increase e-file participation and advance the ETA vision. Some of these relate to steps that would further reduce obstacles to perfecting e-filed returns that are initially rejected, thereby reducing the number of such e-file “reject returns” that must default to paper. Other ETAAC suggestions are designed to eliminate certain paper-based processing steps, concerning the sharing of data with the states, which inhibit greater e-file volumes under the Combined Federal/State Filing Program for information returns. The ETAAC recommendations in these areas also strike the Board as worthy of careful consideration by the IRS and the Board encourages the IRS to do so.

Conclusion

In the view of the Board, electronic tax administration is the foundation for a truly modern IRS that serves taxpayers, tax professionals, and IRS employees efficiently and effectively. Having secure, comprehensive, and easy-to-use systems for the electronic filing of major tax returns is a critical component of the ETA vision. Thus, pursuit of an 80 percent e-file rate for all major tax returns by the year 2012 remains a highly worthwhile, if challenging, goal for the IRS. Ultimately, however, the broader goal of electronic tax administration is to leverage that data in a modern and strategic fashion to improve service to taxpayers and increase voluntary compliance.

Endnotes

1. Electronic Tax Administration Advisory Committee, *Annual Report to Congress*, June 2009, Publication 3415 (Revised 6-2009).
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